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SUBJECT: VIEWS FROM AN EPICENTER OF THE SUBPRIME CRISIS IN GERMANY

REF: A. 07 BERLIN 1575

[1](#)B. 07 BERLIN 1746

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[1](#)1. (SBU) Summary: Senior bankers and regulators involved in the subprime crisis in North-Rhine Westphalia (NRW) told a Treasury delegation led by DAS Mark Sobel on January 9 that the crisis is not yet over in Germany. After the bailouts of Duesseldorf-based IKB and Leipzig-based SachsenLB, senior regulators at the Bonn-based financial watchdog BaFin are keeping a close eye on the investment activities of one large private bank in Germany and NRW state-owned WestLB, which has suffered losses unrelated to the ongoing crisis. Our interlocutors expect "more surprises" during the first quarter when annual reports will be published. Bankers openly praised the European Central Bank (ECB) and the Fed for their timely actions, but were cautious in commenting on BaFin regulators. End Summary.

Hindsight is 20/20

[1](#)2. (SBU) During a January 9 visit to Duesseldorf and Bonn of a Treasury delegation led by DAS Mark Sobel, senior bankers and regulators uniformly blamed rating agencies and banks' heavy reliance on those ratings for subprime losses in the banking sector. A senior WestLB executive summarized views, observing that "we've learned not to rely on external rating agencies but on our internal capacities." A senior BaFin official agreed, stressing that banks need to develop their own independent models of evaluation.

IKB Still on Shaky Ground

[1](#)3. (SBU) A senior IKB executive told the delegation that the bank still must undergo more restructuring, including recapitalization and finding a new capital investor. A buyer with deep pockets would put the bank in a position to do better, but if markets deteriorate "we are still in trouble," he added. In the last six months, the bank has tried to clean up, firing four of five board members, initiating a criminal investigation to determine if the crisis was a result of bad management or fraud, and strengthening transparency by changing auditors and accountants. The IKB official claimed that these actions have worked and IKB has not lost the confidence of its clients.

WestLB: Consolidation vs. Privatization

¶4. (SBU) West LB senior executives agreed that NRW Minister President Ruettggers is trying to retain control of the bank for political reasons, stating that he feels responsible for employment numbers and worries how the public would respond to a privatization. They added that from an economic perspective, the decision to consolidate instead of privatize is questionable. A senior BaFin official observed that WestLB is in a difficult situation, as the national savings bank association cannot afford another five billion euros to bail the bank out, which would then require the state of NRW to step in. The EU Commission, however, has the option to speed up the process of a possible private sector offer, he noted, if they were to reject the use of public funds to bail out the bank.

¶5. (SBU) The delegation also met with another private sector bank, HSBC, which characterized itself as a "subprime-free zone" because it had largely weathered the financial sector turmoil by its tough risk-averse portfolio management. It said the banks in trouble had no one to blame but themselves. Senior bankers were cautious in their comments regarding their past and present relationship with BaFin. They would only say that they are in close contact with BaFin, "who knows exactly what is going on at WestLB, even if the public does not."

More Subprime Crisis Pain to Come

¶6. (SBU) A senior BaFin official described the crisis as the deepest he had seen in his 35 years of practice and stated that "it's not over." There is general consensus among both NRW-based bankers and regulators that annual reports to be released in the first quarter will shed more light on the crisis. BaFin has encouraged banks to use the reports to lay out their problems, arguing that it is much better to get the pain over with than to draw it out over a longer period of time. Preliminary reports from larger banks will be released in February, with final reports expected in March. Annual reports from public banks will be available in mid-April.

¶7. (SBU) BaFin expects the annual reports to lead to the discovery of a few more problem cases, but has already

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identified at least one more bank facing difficulties. BaFin is keeping a close eye on a large private bank, which is "not burning now," but which may experience trouble in the near future as a result of its holdings of structured investment vehicles (SIVs). BaFin expressed particular concern that the SIVs consist of student loans and credit card debt.

ECB and Fed Lauded for their Interventions

¶9. (SBU) Bankers lauded both the ECB and the Federal Reserve for their timely and vigorous interventions. One called the ECB actions "a huge stabilizing factor" and another concurred that the ECB and the Fed did a very good job at preventing a major crisis.

Comment

¶10. (SBU) NRW banks and regulators are sitting tight as they wait for annual reports to be published. The next few months will be key, which may explain why our interlocutors were reticent in their comments on regulations. The delegation's meetings indicated that BaFin is focusing less on "lessons learned" than on the present and near term, on the grounds that the crisis may not be over. For now, NRW actors seem to be in a holding pattern, hoping for the best, but bracing for more possible rough weather.

¶11. (U) This message was coordinated with Embassy Berlin and cleared by Treasury DAS Sobel.
BOYSE